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BEFORE THE ARIZONA CORPORATION COMMISSION

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AZ CORP COMMISSION
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IN THE MATTER OF THE FILING BY
TUCSON ELECTRIC POWER COMPANY
TO AMEND DECISION NO. 62103

DOCKET NO. E-01933A-05-0650

**RESPONSE TO TEP's MOTION
TO AMEND DECISION NO. 62103**

Arizona Corporation Commission Staff ("Staff") hereby responds to the Motion to Amend Decision No. 62103 ("Motion") filed by Tucson Electric Power Company ("TEP") on September 12, 2005. On September 29, 2005, the Commission's Hearing Division issued a procedural order that requires the parties to respond to TEP's Motion by October 12, 2005.

Staff believes that TEP's Motion should be dismissed at this time for the following reasons: 1) TEP has failed to satisfy the filing requirements set forth in A.A.C. R14-2-103; 2) TEP's Motion is premature; and 3) TEP's Motion fails to sufficiently support and describe the relief that it seeks. If the Commission rejects these arguments and elects to consider TEP's Motion on the merits, Staff believes that the Motion should be dismissed because Decision No. 62103 does not entitle TEP to charge market-based rates, the Commission has already addressed this issue in Track A, and TEP's alleged market-based rate authority is inconsistent with the Arizona Court of Appeals' decision in *Phelps Dodge v. Arizona Elec. Power Coop.*, 207 Ariz. 95, 83 P.3d 573 (App. 2004).

I. TEP's request for rate case relief is both incomplete and premature.

A. Because TEP has failed to satisfy the filing requirements set forth in A.A.C. R14-2-103, TEP's Application is incomplete.

1 Although TEP characterizes its September 12, 2005 pleading as a motion to amend Decision
2 No. 62103, the relief that TEP has requested appears to be rate relief. Specifically, TEP's Motion
3 seeks to establish new rates that would become effective January 1, 2009. It also requests the
4 establishment of an adjustment mechanism, which is typically accomplished in a rate case. *See*
5 *Scates v. Arizona Corp. Comm'n*, 124 Ariz. 73, 601 P.2d 1357 (App. 1979). Finally, it asks for
6 certain rate base determinations, yet another example of typical rate case relief.

7 TEP seeks this relief without satisfying the rate case filing requirements of A.A.C. R14-2-103.
8 These filing requirements exist to ensure that the Commission has the necessary information to allow
9 it to comprehensively evaluate a request for rate relief. Without this information, Staff cannot
10 determine whether TEP's rate request will provide TEP the opportunity to earn a reasonable rate of
11 return or will instead result in unreasonable rates.

12 TEP's Motion focuses upon its request to amend Decision No. 62103. This focus, however,
13 does not excuse compliance with the Commission's rate case filing requirements. Without this
14 required information, the case is not sufficient and should be dismissed.

15 B. Even if TEP were to amend its Motion to remedy these deficiencies, it is likely that TEP's
16 Motion will continue to be premature.

17 Staff acknowledges that it may be possible for TEP to amend its Motion to remedy these
18 deficiencies. TEP may point out that it has attempted to raise these issues in its pending rate review
19 docket, in which TEP had already provided the necessary information to comply with the
20 requirements of the rate case management rule. TEP may argue that Staff cannot now complain that
21 TEP has failed to raise these issues in a rate case when it in fact attempted to address these same
22 issues in its pending rate review. This argument fails to recognize that a request for rate relief must
23 be based upon an appropriate test year. *See* A.A.C. R14-2-103.A(3)(p) (historic test year).

24 By raising these issues in its pending rate review proceeding, TEP would have the
25 Commission set rates that would not become effective until 2009 based upon a 2003 test year. The
26 historic 2003 information is simply too attenuated from the proposed 2009 effective date to provide a
27 meaningful basis for the analysis of proposed rates. And even if TEP were now to supplement its
28 present Motion to include the information required by A.A.C. R14-2-103, Staff questions whether

1 information from an appropriate test period is yet available. TEP could conceivably propose rates
2 based upon a 2004 test year; Staff, however, is not convinced that a 2004 test period is an
3 improvement over a 2003 test period for purposes of determining rates for 2009. In short, TEP's
4 request for rate relief is likely to continue to be premature, even if TEP were to remedy the
5 deficiencies inherent in its Motion. For this reason, TEP's Motion should be dismissed.

6 In the pending rate review, Staff has recommended that the Commission require TEP to file a
7 rate case using a June 30, 2007 test year to allow new rates to take effect when the current rate freeze
8 ends. Staff believes that a rate case in this time period will provide a more appropriate basis for
9 determining TEP's post-2008 rates and for dealing with the issues raised by TEP's Motion.

10 **II. TEP's request for relief pursuant to A.R.S. § 40-252 is vague and incomplete and should**
11 **also be dismissed.**

12 Staff believes that TEP's Motion fails to sufficiently describe the basis for its claim and the
13 details of its requested relief. For example, TEP's Motion states that it will be willing to exclude
14 "certain generation assets" from its rate base in order to minimize the rates that TEP's customers will
15 pay once its rate freeze has expired. (Motion at 4). TEP's Motion, however, fails to identify the
16 specific generation assets involved and fails to establish why excluding generation assets from its rate
17 base will necessarily lead to lower rates.

18 In response to a Staff data request, TEP has stated that

19 the Luna Plant [is] an example of a generation asset that could be
20 excluded from rate base. *TEP will identify any other assets during the
development of this proceeding.*

21 (TEP's Resp. to Staff D.R. MR 1-3 (emphasis added) (attached as Ex. 1)). In an environment of
22 rising wholesale prices, excluding assets from cost-based regulation will not necessarily lead to lower
23 costs for ratepayers. Without knowing the specific assets at issue, it will be impossible for Staff to
24 evaluate the ramifications of TEP's proposal.

25 TEP's Motion is also unclear about the details of its proposed Energy Cost Adjustment
26 Clause. In response to a Staff data request, TEP has stated that the proxy for its adjuster would be
27 calculated based on forward market prices from a third party source, weighted according to the
28 forecasted seasonal shape of the incremental demand, adjusted for losses, and then increased by an

1 adder. (TEP's Resp. to Staff D.R. MR 1-4 (attached as Ex. 2)). TEP's response, however, also
2 includes the following statement:

3 The exact details for the proxy will be determined through negotiations
4 and discussions with Staff and the other parties in this Docket.

5 *Id.* This response candidly acknowledges that TEP's Motion provides only a general description of
6 its energy adjustment proposal. (*See also* Pignatelli Direct at 7, ln. 12).

7 TEP's Motion also requests that the Commission retain the current amortization schedule for
8 the CTC. However, in response to a Staff data request, TEP has acknowledged that retaining the
9 current schedule will not require an amendment to Decision No. 62103. (TEP's Resp. to Staff D.R.
10 MR 1-2 (attached as Ex. 3)). In light of this admission, the purpose of TEP's request on this issue is
11 unclear.

12 TEP appears to view its Motion in this matter more as an invitation to negotiate than as an
13 application to seek specific relief. In order to maintain an application for relief before the
14 Commission, TEP must sufficiently state its claim and support the relief that it seeks. Staff believes
15 that the lack of specificity in both TEP's Motion and its data responses fails to provide a sufficiently
16 clear description of its claim. For that reason, TEP's Motion should be dismissed.

17 **III. Even if TEP were to remedy the deficiencies underlying its Motion, Staff disagrees with**
18 **TEP's assertion that it is entitled to charge market-based generation rates after 2008.**

19 TEP contends that, after its current rate freeze expires at the end of 2008, it will be entitled to
20 charge its standard offer customers market-based generation rates without further action by the
21 Commission. (Motion at 3). TEP's Motion begins with that assumption and then proposes a course
22 of action for addressing and amending that alleged entitlement. Staff, however, does not accept
23 TEP's underlying assumption and believes that TEP's assertions are inconsistent with both the 1999
24 Settlement Agreement and with the Commission's Track A order.

25 A. Decision No. 62103 does not establish that TEP's rates shall be market-based.

26 To the contrary, that decision freezes TEP's rates at current levels until the end of 2008. Like
27 other electric utilities, TEP's rates have traditionally been determined based upon cost of service
28 principles. There is no reason to conclude that TEP's rates, which were frozen pursuant to Decision

1 No. 62103 and were indisputably cost-based prior to that decision, somehow became market-based
2 after the Commission's issuance of Decision No. 62103.

3 TEP is correct that Decision No. 62103 refers to a "market generation credit" or "MGC";
4 however, that discussion addresses issues related to stranded cost recovery, not ratesetting. Decision
5 No. 62103 at 4, 16-18. Nowhere does that discussion purport to set rates post-2008 or to determine
6 how rates will be set.

7 The Commission's electric competition rules contemplated cost-based ratesetting for utility
8 distribution companies, such as TEP. Pursuant to the rules and the settlement agreement, TEP was
9 required to transfer its generation assets to a subsidiary on or before December 31, 2002. (Settlement
10 Agreement at 7). After the transfer, TEP would have been required to obtain generation to serve its
11 standard offer customers from the wholesale market in accordance with the Commission's electric
12 competition rules. (Settlement Agreement at 7-8). The Settlement Agreement is silent as to how the
13 Commission was to set standard offer rates after 2008. Given this silence, there is no reason to
14 presume that the Commission intended to depart from the provisions of the electric competition rules.
15 Those rules classify "standard offer service" as a noncompetitive service and provide that standard
16 offer rates "shall reflect the costs of providing the service." A.A.C. R14-2-1601(30), -1606(c)(4).
17 Absent an express finding to the contrary, there is no reason to reach a different conclusion.

18 B. The Commission's Track A order is inconsistent with TEP's assertion that it is entitled
19 to market-based rates.

20 Even if TEP were able to establish that Decision No. 62103 granted it market-based rates, it is
21 unreasonable to conclude that the Commission's Track A order has left this result undisturbed. In the
22 Track A decision, the Commission specifically prohibited TEP from transferring its generation assets.
23 Decision No. 65154 at 32. The Commission took this action to prevent ratepayers from being
24 subjected to the volatility of the wholesale market. There is no reason to conclude that the
25 Commission would prohibit TEP from transferring its generation assets to a subsidiary but at the
26 same time allow TEP to charge its customers market-based rates for that generation, as the latter
27 action would cancel the protections inherent in the first. In summary, the question of how TEP's
28 rates will be set post 2008 has been answered: Track A contemplates that TEP will retain its

1 generation assets and that those assets will be dedicated to serving its customers on a traditional cost-
2 of-service basis. *See* Decision No. 65154 at 22-25.

3 C. TEP's concept of market-based rates is inconsistent with the requirements of *Phelps*
4 *Dodge*.

5 The concept of market-based rates has been questioned by the Arizona Court of Appeals in
6 *Phelps Dodge v. Arizona Elec. Power Coop.*, 207 Ariz. 95, 104-05, 83 P.3d 573, 582-83 (App. 2004).
7 In that case, the court stated that the Commission may not delegate its rate setting function to the
8 market, but must ensure that utility rates are just and reasonable, even in circumstances where rates
9 may be influenced by competition. *Id.*

10 TEP seems to believe that, after 2008, its generation rates may be established solely by
11 reference to a market measure. (Motion at 3). TEP overlooks the fact that *Phelps Dodge* requires the
12 Commission to establish a range of rates with authorized maximum and minimum rates and requires
13 the Commission to determine that the rates within the established range are just and reasonable.
14 Allowing rates to be determined according to some market measure would appear to abdicate the
15 Commission's ratesetting function to the market, the very result that was criticized by the *Phelps*
16 *Dodge* court. *Id.* 207 Ariz. at 106, 83 P.3d at 584. The market-based rate authority that TEP
17 describes is unlikely to satisfy the requirements of *Phelps Dodge* and therefore is unlikely to result in
18 reasonable rates.

19 **IV. Conclusion**

20 Staff believes that TEP's Motion should be dismissed at this time for the following reasons:
21 1) TEP has failed to satisfy the filing requirements set forth in A.A.C. R14-2-103; 2) TEP's Motion is
22 premature and historic 2003 information is too attenuated from a proposed 2009 effective date for
23 new rates; and 3) TEP's Motion fails to sufficiently support and describe the relief that it seeks. If
24 the Commission rejects these arguments and elects to consider TEP's Motion on the merits, Staff
25 believes that the Motion should be dismissed because Decision No. 62103 does not entitle TEP to
26 charge market-based rates, the Commission has already addressed this issue in Track A, and TEP's
27 alleged market-based rate authority is inconsistent with the Arizona Court of Appeals' decision in
28 *Phelps Dodge*. Finally, consistent with Staff's recommendation in TEP's pending rate review, Staff

recommends that the Commission require TEP to file a rate case using a June 30, 2007 test year to allow new rates to take effect once the current rate freeze expires.

RESPECTFULLY SUBMITTED this 12TH day of October, 2005.

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12th day of October, 2005 with:

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**Tucson Electric Power Company's
Responses To Staff's 1st Set Of Data Requests
Docket No. E-01933A-05-0650
September 26, 2005**

MR 1-3: At page 4 lines 22 thru 26 of the Motion to Amend TEP proposes not to seek base rate treatment for certain generating assets.

- A. When does TEP plan on revealing the identity of these assets?
- B. Were these assets accounted for when TEP developed its estimate of a 10-15% rate increase post '08? If so how?

RESPONSE:

- A. In Mr. Pignatelli's Direct Testimony, he identifies the Luna Plant as an example of a generation asset that could be excluded from rate base. TEP will identify any other assets during the development of this proceeding.
- B. No. No assets were used in calculating the 10-15% as it was based solely on a market-based MGC. See response to MR-1.

RESPONDENT: David Hutchens

**Tucson Electric Power Company's
Responses To Staff's 1st Set Of Data Requests
Docket No. E-01933A-05-0650
September 26, 2005**

MR 1-4:

At page 5 of the Motion to Amend the Establishment of an Energy Cost Adjustment Clause ("ECAC") is discussed. As part of the ECAC, TEP proposes the use of "a proxy set at forward power prices."

- A. Please explain how TEP proposes that the proxy would be calculated.
- B. Does TEP propose to recalculate the proxy annually?

RESPONSE:

- A. TEP proposes that the proxy be calculated at the end of 2008 for 2009 based on forward market prices from a third party source, such as Platts Energy Trader or an energy broker, and weighted according to the forecasted seasonal shape of the incremental demand. The price will be adjusted for losses and will include an Adder similar to the current MGC calculation. At the end of 2009, the new proxy for 2010 will be similarly calculated.

The exact details for the proxy will be determined through negotiations and discussions with Staff and the other parties in this Docket.

- B. Yes. TEP would propose that this proxy be recalculated annually for the next year.

RESPONDENT: David Hutchens

**Tucson Electric Power Company's
Responses To Staff's 1st Set Of Data Requests
Docket No. E-01933A-05-0650
September 26, 2005**

MR 1-2:

At page 4 of the Motion to Amend the retention of the current CTC amortization schedule is discussed. Please confirm that with respect to the CTC, TEP is seeking no change in Decision No. 62103. If this is not the case please explain what specific changes to Decision No. 62103 TEP is seeking with respect to the CTC.

RESPONSE:

We confirm that in lines 4 to 12 of page 4 of the Motion to Amend the Company is seeking no change in Decision No. 62103 with respect to the CTC.

In lines 13 to 21, the Company is bringing to the Commission's attention the fact that the recovery of the costs deferred by Decision No. 62103 for Retail Access Implementation needs to be addressed, either through the reopening of this docket, or through the Rate Review docket, Docket No. E-01933A-04-0408. If there is no recovery of these costs provided, the Company will have to write off the Retail Access Implementation costs. The Company suggests that one mechanism to consider to recover Retail Access Implementation costs would be to institute a surcharge equal to the amount of the Fixed CTC, effective immediately after the expiration of the Fixed CTC. This amount would recover the Retail Access Implementation Costs over a few months, and allow future rates to be unburdened of any costs related to the transition to competition as provided for in Decision No. 62103.

RESPONDENT: Karen Kissinger